



# Report of the Office of Inspector General



DEPARTMENT OF THE TREASURY  
WASHINGTON

INSPECTOR GENERAL

To the Commissioner of the U.S. Customs Service:

We audited the U.S. Customs Service (Customs) Balance Sheet as of September 30, 1998, and the related Statements of Net Cost, Changes in Net Position, Budgetary Resources, Financing and Custodial Activity for the year then ended. This report presents our unqualified opinion on these financial statements. Our audit disclosed the following material weaknesses relating to:

- Improving and integrating core financial systems (repeat condition, page 4), and
- Accelerating efforts to ensure timely restoration of mission-critical systems (repeat condition, page 5).

In addition, our audit disclosed 6 reportable conditions, and 2 instances of reportable noncompliance with laws, regulations, and government-wide requirements. These findings are described in more detail in the following sections of the report.

## MANAGEMENT'S RESPONSIBILITIES

Management is responsible for:

- Preparing the financial statements in conformity with Federal accounting standards and for preparing the Overview of Customs (as defined on page 3), required supplemental information, and other accompanying information.
- Establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the benefits and related costs of internal accounting policies and procedures.
- Complying with laws, regulations, and government-wide requirements applicable to Customs.

## SCOPE OF AUDIT

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In planning and conducting our audit of Customs' financial statements for the year ended September 30, 1998, we considered its internal control over financial reporting and compliance with laws and regulations. Specifically, we obtained an understanding of the design of Customs' internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting and compliance with laws and regulations. Consequently, we do not provide an opinion on such controls.

In addition, with respect to internal controls related to performance measures reported in the Overview of Customs, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions



and determined whether they had been placed in operation. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of Customs' compliance with (a) certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and (b) certain other laws and regulations specified in OMB Bulletin No. 98-08, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under FFMIA, we are required to report whether Customs' financial management systems substantially comply with the following three general requirements: Federal Financial Management Systems Requirements, Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin No. 98-08, as amended.

We have read the information in the Overview of Customs and other accompanying information and assessed whether such information, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements.

## RESULTS OF AUDIT

### OPINION ON THE FINANCIAL STATEMENTS

In our opinion, the financial statements present fairly, in conformity with Federal accounting standards, as described in Note 1, which is a comprehensive basis of accounting other than generally accepted accounting principles, the assets, liabilities, and net position of Customs as of September 30, 1998, and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activity for the year then ended.

### OTHER INFORMATION

In this report, we refer to the information in the following parts of the *U.S. Customs Service Fiscal Year 1998 Accountability Report* as the Overview of Customs:

- Messages from the Commissioner and Chief Financial Officer (pages 4 - 5).
- Customs' discussion of its mission, FY98 operational and financial results, Year 2000 initiatives, and FMFIA (pages 6 - 47).

Our audit was conducted for the purpose of expressing an opinion on Customs' fiscal year 1998 financial statements referred to above. The information contained in the Overview of Customs and other accompanying information is not a required part of the financial statements but is supplementary information required by OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it. However, we compared this information for consistency with the financial statements and, based on this limited work, we found no material inconsistencies.

### INTERNAL CONTROL

Internal control is a process, effected by Customs' management and other personnel, designed to provide reasonable assurance that the following objectives are met:

- Reliability of financial reporting - transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with Federal accounting standards, and the safeguarding of assets against loss from unauthorized acquisition, use, or disposition;



- Compliance with applicable laws and regulations - transactions are executed in accordance with: (a) laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements, and (b) any other laws, regulations, and government-wide policies identified in OMB Bulletin No. 98-08, as amended; and
- Reliability of performance reporting - transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

Because of limitations inherent in any internal control, errors or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that internal control may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

As defined in OMB Bulletin No. 98-08, as amended, reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of the internal control, that could adversely affect Customs' ability to meet the internal control objectives as defined above. Material weaknesses are reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We identified the following matters involving the internal control and its operation that we consider to be material weaknesses and other reportable conditions as defined above. These matters were also identified as material weaknesses or other reportable conditions in our report *Report on the U.S. Customs Service's Fiscal Years 1997 and 1996 Financial Statements*, (OIG-98-050, issued March 5, 1998).

We considered the material weaknesses described below in forming our opinion on whether Customs' financial statements as of September 30, 1998, and for the year then ended are presented fairly, in all material respects, in conformity with the accounting policies described in the footnotes to these financial statements, and these weaknesses do not affect our opinion expressed above.

## **Material Weaknesses**

### **Core Financial Systems Need To Be Improved and Integrated (Repeat Condition)**

Customs' core financial systems did not provide for a "customer-based" non-entity accounts receivable subsidiary ledger that interfaced with the general ledger. Certain transactions were not recorded properly in the financial systems as they occurred, such as seized currency transactions, the use of appropriations, and the recordation of a liability upon receipt of goods and services. Additionally, financial systems were not fully integrated with each other. As a result, extensive manual procedures and analyses were required to process certain routine transactions and to prepare financial statements at fiscal year-end.

Furthermore, Customs based certain reimbursements to appropriated funds from user fees and billings for reimbursable activities on estimates instead of actual costs. Controls also need to be strengthened to ensure that (a) all payments and refunds related to an import entry are recorded against the import entry record in Customs' revenue accounting system, the Automated Commercial System (ACS), and (b) overrides of ACS system controls to detect possible overpayment of refunds are subject to supervisory approval.

### **Efforts To Ensure The Timely Restoration Of Mission-Critical Systems Need To Be Accelerated**

We have identified significant deficiencies in Customs' ability to provide for timely restoration of mission-critical systems that, in our view, would impair Customs' ability to respond effectively to a disruption in operations. Portions of this finding include repeat conditions relating to disaster recovery capabilities. Due to the sensitive nature of this matter, we are providing further details in a separate report with limited distribution.



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## Reportable Conditions

### **Drawback<sup>1</sup> Controls Need To Be Strengthened (Repeat Condition)**

Customs' controls over drawback continued to need improvement during fiscal year 1998. Existing procedures over drawback should be strengthened and enforced to prevent duplicate, excessive, or otherwise improper drawback payments. Such procedures are essential because once drawback payments are made and the related claim is liquidated,<sup>2</sup> Customs does not have legal authority to demand a return of overpaid drawback, unless fraud is involved.

### **Controls Over Bills Of Lading And In-Bond Shipments Need To Be Strengthened (Repeat Condition)**

Customs' controls over "open" bills of lading<sup>3</sup> and in-bond shipments<sup>4</sup> continued to need improvement during fiscal year 1998. Customs was unable to ensure goods moving in-bond were not diverted into the United States commerce without proper appraisement. While Customs did implement certain planned improvements to its operating and system controls, these improvements were not implemented until September 1998.

### **Compliance Measurement Programs Need To Be Comprehensively Implemented To Identify The Revenue Gap<sup>5</sup> And Assess Trade Law Compliance (Repeat Condition)**

During fiscal year 1998, Customs continued its statistically-based examination programs, referred to as compliance measurement programs (CMP). CMPs are designed to quantify the revenue gap and assess trade law compliance. Among Customs' most critical CMPs are: (a) the consumption entry CMP which projects revenue over- and under-collection, (b) the carrier manifest<sup>6</sup> CMP which measures the accuracy of carrier reporting of cargo arriving in the United States, (c) the bonded warehouse CMP which measures compliance by bonded warehouse operators, and (d) the in-bond CMP, initiated in September 1998, which measures the accuracy of cargo information provided on the in-bond authorization form for merchandise allowed to move within the United States without classification or appraisement. We noted that Customs did not subject all entered cargo to the consumption entry CMP. Although Customs implemented the bonded warehouse CMP in fiscal year 1997, it did not conduct any bonded warehouse CMPs during fiscal year 1998. Additionally, Customs needs to formulate a CMP for foreign trade zones. Until Customs fully implements a comprehensive set of CMPs, it lacks the information it needs to focus its trade compliance efforts.

### **Accountability Controls Over Covert Operations Need Improvement (Repeat Condition)**

Our tests of covert operations revealed that certain critical control procedures were not in place or were not consistently followed. Specifically, we noted that bank statement reconciliations were not consistently performed and required periodic reviews of accounting records by personnel independent of the operations were not always performed. Bank statement reconciliations and periodic independent reviews are essential to ensure the financial integrity of covert operations. Additionally, some advances recorded in the covert operations financial records could not be reconciled with Customs' general ledger accounts.

### **Computer Systems Continue To Be Vulnerable To Unauthorized Access (Repeat Condition)**

Security weaknesses continued to exist during fiscal year 1998 that could allow for unauthorized modification and deletion of production programs and data in Customs' major computer application systems for trade, financial

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<sup>1</sup> Drawback payments are refunds of duties and taxes paid on imported goods that are subsequently exported or destroyed. Claimants have up to 8 years after import to file for drawback.

<sup>2</sup> Drawback liquidation is the process by which a Customs drawback specialist verifies the drawback due based on the drawback claim submitted. As part of the liquidation process, drawback specialists review a sample of related import entries to determine that the claim amount does not exceed the total amount of duty and tax paid on the related import entry(s).

<sup>3</sup> A bill of lading is a written receipt for goods sent by common carrier, and is a contract between the shipper and the carrier. The bill of lading includes the general description and the quantity of the goods entering the United States.

<sup>4</sup> In-bond shipment refers to goods authorized, by law, to move within the United States prior to release or export without appraisement and classification.

<sup>5</sup> The revenue gap (referred to as the tax gap in Federal accounting standards) is defined as taxes or duties due from non-compliant taxpayers or importers, and is an estimate based on Government surveys or studies. Since the tax gap cannot be identified to specific taxpayers or importers, the estimate is not recorded on Customs' financial statements as an accounts receivable.

<sup>6</sup> A manifest is a carrier document which lists a general description of all goods on the conveyance, and who owns the goods. The carrier certifies to the accuracy of the manifest.



management, and law enforcement activities. Specifically, systems and application programmers had unnecessary access to production programs and data files and other personnel had access to sensitive system privileges which could allow them to circumvent job submission security and auditing. Additionally, systems monitoring procedures were not consistently performed and Customs was unable to determine the physical location of several systems consoles.

#### **Adherence To Systems Development Standards Needs Improvement <sup>7</sup> (Repeat Condition)**

Customs did not always adhere to systems development standards. Application documentation for ACS was incomplete. Additionally, formal written procedures did not exist for the change control process and the use of a production code checkout procedure was not enforced. These conditions could result in changes being introduced into the production system that are not authorized, properly tested, or reviewed.

*William H. Pugh*

Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

### **COMPLIANCE WITH LAWS AND REGULATIONS**

The results of our tests of compliance with the laws and regulations, exclusive of FFMIA, disclosed one instance of noncompliance with the following laws and regulations that are required to be reported under Government Auditing Standards and OMB Bulletin No. 98-08, as amended. This instance is described below:

The Chief Financial Officers Act of 1990 requires Customs to conduct a biennial review to determine the appropriateness of fees and other charges imposed by it for services and things of value it provides. Similarly, the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985, as amended, requires Customs to conduct a biennial review of user fees imposed under COBRA at the close of each even-numbered fiscal year. Customs did not conduct the biennial review of fees and charges for its reimbursable projects. However, it attempted to analyze COBRA fees based on fiscal year 1997 data but the data was not complete to determine if fees should be adjusted.

Except for the instance described above, the results of our tests of compliance disclosed no other instances of noncompliance with other laws and regulations, exclusive of FFMIA, that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 98-08, as amended.

The results of our tests disclosed instances where Customs' financial management systems did not substantially comply with the requirements referred to in FFMIA, specifically as they relate to the Federal Financial Management Systems Requirements (FFMSR).<sup>8</sup> These instances are summarized below and are discussed in more detail along with Customs' planned remedial actions and time frames to implement such actions in the schedule titled "Open Section 4 Non-conformances as of September 30, 1998" on page 47 of the *U.S. Customs Service Fiscal Year 1998 Accountability Report*.

- Customs financial systems do not provide complete and accurate information for financial reporting and preparation of audited financial statements.
- Automated systems for tracking and accounting for seized currency and property were not reliable.

This report is intended solely for the information and use of the management of Customs, the U.S. Department of the Treasury, OMB, and the Congress, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is available to the public as a matter of public record.

<sup>7</sup> This reportable condition refers to Customs' existing financial management systems. The findings and recommendations in the U.S. General Accounting Office's recently issued report, *Customs Modernization: Serious Management and Technical Weaknesses Must Be Corrected* (AIMD-99-41, issued February 26, 1999), refers to system development weaknesses related to the development of new systems.

<sup>8</sup> FFMSR are a series of requirements produced by the Joint Financial Management Improvement Program (JFMIP) to improve federal financial management through uniform requirements for financial information, financial systems, and financial organization.



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January 22, 1999